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SECTOR COMMENT
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Electric and Gas – US

Securitization will be a shock absorber for ERCOT defaults from February storm

On 31 May, the Texas (Aaa stable) legislature passed House Bill 4492 and Senate Bill 1580, which work together to authorize the use of securitization and financing from the state's main budget reserve, the Economic Stabilization Fund (ESF), to cover the substantial unpaid balances of electric cooperatives and retail energy providers to the wholesale power market totaling about $3 billion. SB 1580 allows electric cooperatives to securitize their share of the unpaid balance, currently totaling $2.5 billion, while the remaining amount will be covered by default balance financing authorized by HB 4492. The legislation, which is supported by Gov. Greg Abbott, is credit positive for utilities with generation because they will allow for timely repayment for amounts earned from dispatching generation resources into the Electric Reliability Council of Texas Inc. (ERCOT, A1 negative) market during the February winter storm referred to as Winter Storm Uri. HB 4492 also authorizes financing of up to $2.1 billion for reliability deployment price adder charges and ancillary services in excess of the systemwide offer cap of $9,000 per MWh. This provision is positive for utilities whose financial losses from the winter storm were compounded by these additional charges.

Securitization is an effective tool in the aftermath of a catastrophe because it spreads out costs over many years and minimizes the impact on customer rates. This, in turn, helps issuers manage their exposure to social risks related to customer relations and access to basic services. The bills seek to address the substantial market shortfall and extraordinary costs resulting from the severe winter storm that swept through the state in mid-February 2021. The storm affected much of the central and southern US, but the extent and duration of electricity blackouts were much more severe in Texas, specifically within the territory served by ERCOT. Electric generating assets tripped offline and fuel supplies were squeezed, resulting in extremely high power and gas prices.

SB 1580 authorizes securitization financing, enabling electric cooperatives to pay their own defaulting balances. Brazos Electric Cooperative and Rayburn Country Electric Cooperative defaulted on amounts owed to the wholesale market and represent about $2.5 billion of the $3 billion cumulative defaulted invoices (see Exhibit 1). The remaining defaulting balance not recovered by SB 1580 will be funded by a loan to ERCOT from the state's economic stabilization fund balance (the rainy day fund), authorized by HB 4492. When market participants default on amounts they owe for power purchases, ERCOT will first draw from financial security provided by the defaulting participants and then “short-pay” participants, which means it reduces settlement payments to invoice recipients owed money from ERCOT.

Exhibit 1
Brazos and Rayburn cooperatives represent the bulk of ERCOT invoice defaults
Short-pay amounts owed by ERCOT counterparties

Counterparty	Short-pay amount ($)
Brazos Electric Power Co Op Inc	1,879,466,498
Rayburn Country Electric Cooperative Inc	640,510,035
Entrust Energy Inc	296,555,580
Hanwha Energy Usa Holdings Corp d/b/a 174 Power Global	50,177,025
Iluminar Energy LLLC	42,045,416
Griddy Energy LLC	30,040,670
Gbpower LLC	20,317,539
MQE LLC	13,713,515
Energy Monger LLC	8,884,384
Volt Electricity Provider LP	6,435,245
Gridplus Texas Inc	1,478,516
Eagles View Partners Ltd	1,152,199
Power Of Texas Holdings Inc Virtual	16
TOTAL	**2,990,776,638**

Source: ERCOT settlement notice dated 28 May 2021

HB 4492 establishes two financing mechanisms. First, the Winter Storm Uri Default Balance Financing provision authorizes the ESF to lend up to $800 million to ERCOT to finance the default balance, which refers to the remaining share of the short-pay amount shown in Exhibit 1 that will not be securitized under SB 1580. The loan will be repaid from “default charges” assessed to wholesale market participants for a term of up to 30 years. While $800 million is the cap, we expect the actual loan amount will be about $500 million since the other $2.5 billion will be recovered by SB 1580 securitization. ERCOT will use the proceeds to replenish cash from congestion revenue rights accounts that were withdrawn to temporarily reduce the short-pay allocation to the wholesale market.

Language in HB 4492 bears some of the hallmarks of securitization, including the state's non-impairment pledge, requirements for charges that are nonbypassable, and true-up mechanisms for charges to be reviewed at least once annually for over- or under-collections. There must also be a finding that the financing serve a public interest that would not be available in the absence of the debt obligation, which is a typical feature of securitization. However, HB 4492 does not call for issuance by a bankruptcy-remote special purpose entity (SPE), or specify that the conveyance of the assets will constitute a true sale, which is a key facet of a standard securitization. A utility using securitization would typically sell the securitized asset to the SPE in a true sale transaction, which protects securitization investors from potential claims on cash flows by the utility's creditors in a bankruptcy. HB 4492, nevertheless, does specify that the only source of payment on the debt are the special charges. The debt authorized by HB 4492 does not create a personal liability for ERCOT and no assets of ERCOT are subject to claims by holders of the debt obligations.

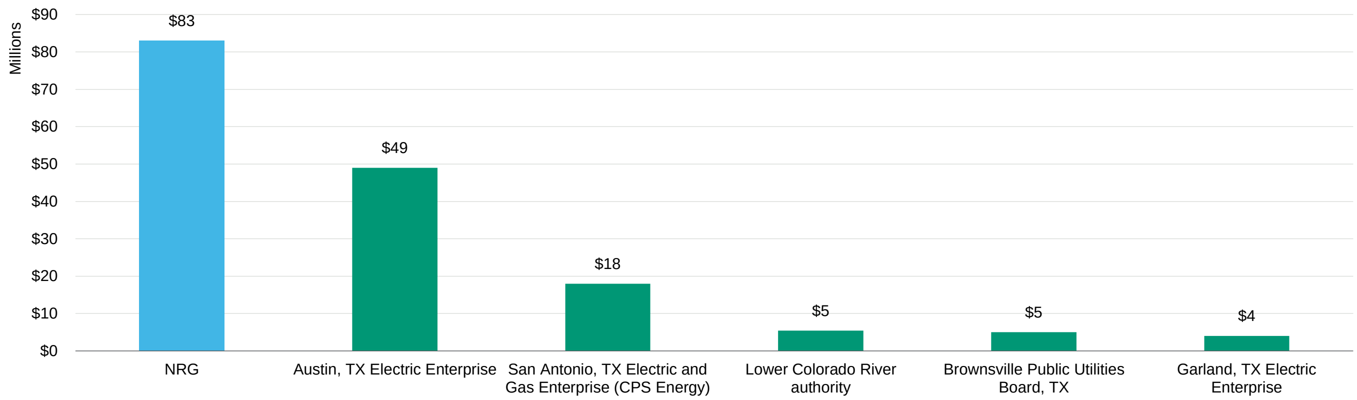
HB 4492 and SB 1580 together provide an alternative to ERCOT's “default uplift” process, which invoices participants based on market activity up to a maximum of $2.5 million every 30 days. Full recovery of the $3 billion short-pay would take about 100 years at that rate. ERCOT has held off on initiating default uplift invoices while the legislation was in session through 31 May.

Proceeds from the financings will allow wholesale participants that were short-paid to be paid back much faster than under ERCOT's default uplift protocol. Many of them incurred substantial natural gas bills to keep gas-fired power plants available and producing during the storm. When there is a short-pay, payments are reduced to an amount necessary to keep ERCOT revenue-neutral and are allocated on a pro rata basis. In their reporting on total estimated financial losses from the storm, NRG Energy Inc. (Ba1 stable) reported an $83 million short-pay (see Exhibit 2). Vistra Corp. (Ba1 stable) has not disclosed its short-pay amount. Short-pays allocated to municipal utilities were comparatively lower, as shown in Exhibit 2, because they represent a smaller share of activity and net settlement payments at that time.

Exhibit 2

ERCOT short-paid, or paid less than what was owed, to wholesale market participants to remain revenue neutral

Estimated short-pay allocations by selected rated utilities with independent power producers depicted in blue and municipal utilities in green



Source: Issuer disclosures to the public and to Moody's

The Cities of Denton, TX and San Antonio (City of) TX Combined Utility Enterprise (CPS Energy, Aa1 negative) were granted temporary restraining orders that prevent ERCOT from invoicing short-pays and default uplift charges to these cities. The cities alleged that, under the Texas constitution, municipal utilities cannot be asked to extend their credit to settle the debts of other entities. Their respective short-pays have been allocated to the rest of the market since the restraining orders went into effect. On 4 June 2021, however, the court dismissed Denton's case based on jurisdiction. The potential for future litigation introduces some uncertainty, but at this point, we expect that the default charges from the $800 million authorization in HB 4492 will still flow to their customer bases. The default charges will be calculated using the same pro rata methodology under ERCOT's default uplift protocol reflecting market activity.

The second financing mechanism established by HB 4492 is the Winter Storm Uri Uplift Financing provision, which authorizes up to $2.1 billion to finance uplift costs, which is not to be confused with ERCOT's default uplift protocol to socialize short-pay balances. The meaning of “uplift” in this section refers to certain charges that exceeded the systemwide cap of $9,000 per MWh that were charged to load-serving entities on a load ratio share basis. In this case, the uplift costs are the real-time operating reserve demand curve (ORDC) adder and ancillary services. The ORDC artificially boosts real-time energy prices when power supply runs low, in theory to incentivize generation during scarcity pricing periods. Ancillary service charges are paid to generators and are designed to keep system frequency at 60 Hertz, otherwise the grid becomes unstable. In its quarterly earnings presentation, NRG described $395 million of negative impact from “unhedgeable uplift costs.” A portion of this reflecting the uplift costs that were higher than the $9,000 MWh cap would likely be considered eligible costs. Garland, TX Electric Enterprise (Aa3 negative) also estimates $12 million from ancillary service charges that could be eligible for financing. If a cost advantage can be demonstrated, uplift financing under HB 4492 could alleviate this burden by remitting proceeds to entities exposed to these costs, moving the liability off-balance sheet, and spreading the costs to the market at a more favorable interest rate for a period of up to 30 years.

Uplift charges that will repay the uplift debt obligation will be assessed by ERCOT to all load-serving entities on a load ratio share basis, which may be translated to a kWh charge. The charges are nonbypassable, but HB 4492 allows some entities to opt-out if they pay in full all amounts owed for usage during the winter storm and do not receive any proceeds from the uplift financing.

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- Public Power Electric Utilities – US: Storm fallout pressures liquidity; borrowing will extend cost recovery over many years, 1 March 2021
- Unregulated Electric Utilities and Power Companies – US: NRG and Vistra likely to withstand Texas power outages, 17 February 2021

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